LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

301 State House
(317) 232-9855

FISCAL IMPACT STATEMENT

LS 7124 **DATE PREPARED:** Feb 6, 2002
BILL NUMBER: HB 1356 **BILL AMENDED:** Feb 5, 2002

SUBJECT: Various Tax Matters.

FISCAL ANALYST: Diane Powers
PHONE NUMBER: 232-9853

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: (Amended) (A) This bill specifies circumstances under which a Sales Tax return does not need to be filed each month.

(B) The bill updates references in law to the Internal Revenue Code to refer to the version of the Internal Revenue Code as amended through January 1, 2002.

(C) The bill permits the board of trustees of the South Bend Community Schools to adopt a resolution returning to a calendar year budget cycle. The bill provides that the resolution may be rescinded.

(D) The bill updates population parameters to reflect changes in the 2000 decennial census.

(E) The bill creates a centralized debt collection program for state agencies in the Department of Revenue.

(F) The bill increases the total amount of Sales Tax increment financing distributions that an economic development district in the city of South Bend may receive to $1,000,000 per year and expands the purposes for which the money received by the district may be used to include expenses related to the acquisition of a commercial retail facility or demolition of commercial property.

(G) The bill permits a taxpayer under certain circumstances to amend a 2001 personal property tax return before January 1, 2003.

Effective Date: (Amended) Upon passage; January 1, 2001 (retroactive); January 1, 2002 (retroactive); April 1, 2002 (retroactive); January 1, 2003.

Explanation of State Expenditures: (Revised) **(C)** ***South Bend Community Schools Budget Cycle:*** South Bend Community School Corporation (SBCS) became the fifth school with a budget based on the school year. The General Assembly established a pilot program and was scheduled to move all schools to a school year budget for the 2000-01 school year. SEA 508-2000 repealed the requirement of a school year budget, but allowed four of the pilot schools to retain the school year budgeting process. HEA 1096-2001 changed SBCS's budget year from a calendar year to a school year. The State Board of Tax Commissioners might need to meet with the South Bend Community School Corporation to assist the school in changing from a school year budget back to the calendar year budget. The Tax Board would probably experience no additional expense associated with the change.

(E) ***Department of Revenue Collections (DOR):*** This bill allows the Department to establish a centralized debt collection program within the Department for use by state agencies to collect on delinquent accounts. The bill gives the Commissioner of the Department authority to implement the program and establish the appropriate form and manner is which collection information is to be submitted to the Department. While this bill could have an administrative impact on the Department, the bill contains provisions that are expected to mitigated any impact. The bill allows the Department to retain up to 15% of the delinquent funds collected for a state agency and it reserves the use of the DOR's facilities by other state agency to times when the facilities would otherwise be available.

Explanation of State Revenues: (Revised) **(A)** ***Sales Tax Filing Periods****:* The bill restores statuary language that was deleted under P.L. 185-2001 affecting the frequency in which retailers with a relatively small tax liability must file with the Department of State Revenue (DOR). Under current law, as amended by P.L. 185-2001, retailers with a monthly Sales Tax liability between $25and $75 are required to remit Sales Tax collections monthly. This bill restores language that allows these retailers to instead file quarterly.

Depending on the action of the DOR in conforming their Sales Tax collection requirements and procedures to P.L. 185-2001, this bill *could* cause a one-time forward shift in state Sales Tax collections. However, if the Department has still not conformed to P.L. 185-2001 by the date of this bill's passage, the provision will not have an impact on Sales Tax collections.

(F) ***South Bend Economic Development Project District:*** This bill increases the amount the South Bend redevelopment commission may receive in Sales Tax increment financing. Under current law, these collections are limited to a total of $1 M. This bill will allow the redevelopment commission to receive up to $1 M of the incremental Sales Tax revenue generated within a specified redevelopment project district each year that is *above* the revenue generated in a base year, as determined by the Department of Revenue. The bill does not give the city the privilege to collect a Sales Tax.

Depending on local actions, the bill could decrease the amount of new revenue that the state would receive from increased Sales Taxes. The overall impact of this provision on the state will be determined by local actions and the economic activity within the district. It is not known how much Sales Tax will be collected and transferred annually. The bill limits any transfer to $1 M annually.

Gross Retail (Sales) and Use taxes are deposited in the State General Fund (59.03%), the Property Tax Replacement Fund (40%), the Public Mass Transportation Fund (0.76%), the Commuter Rail Service Fund (0.17%), and the Industrial Rail Service Loan Fund (0.04%).

(B) ***Internal Revenue Code Update:*** This bill updates the reference to the Internal Revenue Code to incorporate all the federal changes made up to January 1, 2002. The Economic Growth and Tax Relief Reconciliation Act of 2001 (HR 1836) made a number of federal tax changes that could affect Indiana state tax revenue. Many of those provisions will impact on state revenue due to changes in Indiana adjusted gross income (AGI) and the Federal Estate Tax.

<u>Provisions which impact Indiana Adjusted Gross Income:</u>

Education IRAs: HR 1836 made a number of changes to the Education IRA laws which are summarized below.

New Contribution Limits- The annual contribution limit is increased from $500 to $2,000. Contributions can be made for special needs beneficiaries after the beneficiary turns 18. Contributions may also be made from corporations, tax-exempt organizations, or other entities. The deadline for making contributions has been extended to April 15 of the following year, instead of December 31st of the tax year.

Higher Adjusted Gross Income Ceiling- The current income limit is increased from $150,000-$160,000 to $190,000-$220,000 for married taxpayers filing a joint return. (The phaseout range for single taxpayers remained at $95,000 - $110,000.)

Grades K-12 Expenses- Qualified expenses are expanded to include elementary and secondary school tuition, tutoring, computer equipment, room and board, uniforms, and extended day program costs.

Qualified Tuition Plans (QTP): HR 1836 allows private postsecondary institutions to establish qualified tuition programs after 2001. Distributions from state-sponsored qualified tuition programs will be exempt if made after 2001. Distributions from non-state programs will be exempt after 2003. Distributions from qualified tuition programs can be rolled over for the benefit of the same beneficiary after 2001. HR 1836 also allows a taxpayer to exclude QTP distributions from gross income and claim the HOPE or Lifetime Learning Credit as long as they are not used for the same expenses.

Employer-Provided Assistance: HR 1836 permanently extended this exclusion from adjusted gross income and expanded it to include graduate level courses after 2001.

Qualified Higher Education Expenses: Beginning in 2002, a taxpayer will be eligible for an "above-the-line" deduction for qualified higher education expenses. This deduction will sunset after 2005. This deduction may not be used in the same year as the HOPE or Lifetime Learning Credit for the same student. The amount of the deduction and income limits are outlined in the table below.

Tax Years Beginning	Modified AGI Limits	Amount of Deduction
2002 & 2003	Not more than $65,000 - Single Filers	$3,000
	Not more than $130,000 - Joint Filers	
2004 & 2005	Not more than $65,000 - Single Filers	$4,000
	Not more than $130,000 - Joint Filers	
	$65,000 to not more than $80,000 - Single	$2,000
	$130,000 to not more than $160,000 - Joint	

Student Loan Deduction: The income thresholds are raised to $50,000 - $65,000 for singles and $100,000 -

$130,000 for joint filers. HR 1836 also repealed the first 60-month limit for which the deduction may be taken on interest payments along with the restriction that voluntary payments of interest are not deductible.

Tax-Exempt Bond Financing: HR 1836 expands the private activities for which tax-exempt bonds may be issued, to include elementary and secondary public school facilities which are owned by private, for-profit corporations under a public-private partnership with a state or local educational agency. These bonds are subject to a separate per-state volume limit equal to the lesser of $10 per resident or $5 M.

Pension and Retirement Savings Provisions: HR 1836 included numerous changes to the tax status of pension and retirement savings mechanisms. This act includes expanding retirement savings incentives along with reforming the current structure of qualified plans. Below is a summary of a few of these changes.

Contribution Limits of Individual Retirement Accounts (IRAs) & Roth IRAs- The amount an individual is allowed to contribute is increased for both the traditional IRA and Roth IRA as outlined below.

Tax Year	Contribution Limit
2001	2,000
2002 - 2004	3,000
2005 - 2007	4,000
2008	5,000
2009 & after	indexed for inflation

Catch-up Contributions- Taxpayers who are 50 and over will be able to make additional contributions to the various retirement savings plans as outlined below. After 2006, the IRS will adjust these amounts by a COLA.

Tax Year	401(k)/ 403(b) / SEP / 457 Plans	SIMPLE	IRAs
2002	$1,000	$500	$500
2003	$2,000	$1,000	$500
2004	$3,000	$1,500	$500
2005	$4,000	$2,000	$500
2006 & after	$5,000	$2,500	$1,000

Defined Benefit Plans- HR 1836 increased the annual benefit limit under a defined benefit plan to $160,000 (currently $140,000). The annual benefit limit will be reduced for benefits beginning before the age of 62, instead of 65, and will increase on benefits beginning after the age of 65.

Defined Contribution Plans- The annual additions limit for defined contribution plans is increased to $40,000 (currently $30,000). (Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer.)

Compensation Limit- The annual compensation of each participant that could be taken into account for purposes of (1) determining contributions and benefits, (2) applying deduction rules, and (3) nondiscrimination testing was limited to $170,000. HR 1836 increased qualified plans' compensation limits to $200,000 and will be indexed for COLAs in $5,000 increments.

Elective Deferral Limits- The limits on the amount of elective deferrals to 401(k), 403(b) annuities, SEPs, SIMPLE, and Section 457 plans are increased by the following amounts.

Tax Year	401(k)/403(b)/SEPs	SIMPLE Plans	Section 457 Plans
2002	$11,000	$7,000	$11,000
2003	$12,000	$8,000	$12,000
2004	$13,000	$9,000	$13,000
2005	14,000	$10,000	$14,000
2006 & after	15,000	$10,000	$15,000

Estate Tax Impact: The Indiana Estate Tax will be phased out in concert with the elimination of the federal Estate Tax under the federal *Economic Growth and Tax Relief Act of 2001*. The federal Generation Skipping Transfer Tax is also repealed in 2010 under the federal *Economic Growth and Tax Relief Act of 2001*. Like the Estate Tax, the Indiana Generation Skipping Transfer Tax is also linked to the federal version of the tax. Thus, the federal repeal will result in the elimination of the Indiana Generation Skipping Transfer Tax with the update to the Internal Revenue Code references to January 1, 2002. According to the Indiana Department of State Revenue, the Generation Skipping Transfer Tax has brought in very little revenue.

Revenue from the Indiana Estate Tax likely will begin to decline in FY 2003. This decline is expected to continue until FY 2007 when the flow of revenue from the tax will likely cease altogether. The revenue decline beginning in FY 2003 will result from the phaseout of the state death tax credit and the accelerated increase in the unified credit under the federal Estate Tax. Ultimately, the revenue loss from the elimination of the Indiana Estate Tax is estimated at approximately $21.2 M. The *incremental* revenue loss each year as a result of the phaseout period is presented in the table below. The revenue loss totals are net amounts based on the difference in expected revenue given changes scheduled under prior federal law and expected revenue given the new federal Estate Tax law.

Year of Revenue Impact	Expected Indiana Estate Tax Revenue	Revenue Loss
FY 2003	$17.4 M	($7.4 M)
FY 2004	$7.0 M	($17.6 M)
FY 2005	$2.7 M	($21.0 M)
FY 2006	$735,000	($21.5 M)
FY 2007	$0	($21.4 M)
FY 2008	$0	($21.2 M)

It is important to note that the provisions of the federal legislation repealing the federal Estate Tax are scheduled to sunset at the end of 2010. The impact of the potential sunset of the Estate Tax repeal is not known. However, the Congress is expected to either extend the repeal provisions or make them permanent at some point prior to the sunset date.

Background:

Indiana Estate Tax: The Indiana Estate Tax is a "pick-up" tax that is imposed separately from the Indiana Inheritance Tax. The Estate Tax liability is based on the amount of Inheritance Tax paid by transferees of the estate and the credit that an estate is allowed to claim under the federal Estate Tax for death taxes paid to the state. For purposes of the federal state death tax credit, "death taxes" can be either estate taxes or inheritance taxes imposed by the state. The Indiana Estate Tax is equal to the amount by which the estate's allowable death tax credit exceeds the total amount of Indiana Inheritance Tax paid by transferees of the estate. Recent revenue totals for the tax are presented in the table below.

Fiscal Year	Indiana Estate Tax Revenue
1999	$24.7 M
2000	$21.0 M
2001	$28.9 M
3-Year Average	$24.9 M

State Death Tax Credit: The federal Estate Tax allows a credit for state death taxes paid in relation to an estate, whether these are estate or inheritance taxes. The allowable state death tax credit is computed from a credit table based on the adjusted taxable value of the decedent's estate, where the adjusted taxable value is the taxable estate value reduced by $60,000.

Impact of the Unified Credit on the Death Tax Credit: The state death tax credit can not exceed the federal estate tax liability after subtraction of the unified credit. The unified credit is taken by federal Estate Tax filers against the Estate Tax liability. The credit effectively exempts a portion of the gross value of any estate from taxation. For estates of decedent's who died in 2001, the unified credit (=$220,550) effectively shelters $675,000 in gross estate value from tax. Therefore, estates of 2001 decedents with a gross value of $675,000 or less would have a federal Estate Tax liability equal to zero. Thus, the state death tax credit is also equal to zero and no Indiana Estate Tax is owed.

Federal Estate Tax Changes:

The Economic Growth and Tax Relief Act of 2001 repeals the federal Estate Tax in 2010. However, two provisions of this legislation will impact the Indiana Estate Tax prior to that time.

(1) The federal legislation phases out the state death tax credit from 2002 to 2005. Under the phaseout, 2001 allowable credit amounts are reduced by 25% in 2002, by 50% in 2003, and by 75% in 2004. The credit is repealed in 2005 and replaced by a deduction from the gross estate value for death taxes actually paid to the state with respect to property included in the gross estate of the decedent. Since the Indiana Estate Tax is a computation utilizing the value of the state death tax credit, reductions in the allowable federal credit amounts will impact revenues from the tax. The repeal of the credit will effectively make the Indiana Estate Tax inoperative for estates of decedents who die in 2005 and subsequent years.

(2) The federal legislation also accelerates the increase in the unified credit that was scheduled to take place under prior law. The applicable exemption value of the unified credit for estates of 2001 decedents is $675,000. Under prior law, the applicable exemption value of the unified credit was scheduled to increase to $700,000 in 2002 and 2003, to $850,000 in 2004, to $950,000 in 2005, and to $1.0 M in 2006 and subsequent years. Under the new federal legislation, the increase in the unified credit is accelerated such that the applicable exemption value increases to $1.0 M in 2002 and 2003, and to $1.5 M in 2004 and 2005 when the state death tax credit is in the last phase of its elimination. The changes to the unified credit are expected to remove estates from the estate tax rolls that would have had a tax liability under prior unified credit levels. This should exacerbate the expected decline in Indiana Estate Tax revenue due to the phaseout of the state death tax credit.

Sunset of Tax Change Provisions. In order to comply with the Congressional Budget Act of 1974, the provisions of the *Economic Growth and Tax Relief Act of 2001* will sunset on December 31, 2010. The impact of this is unknown. However, Congressional observers expect that the provisions of the Act will be extended or made permanent at some point in the future. Reportedly, the House leadership has indicated that legislation to make the provisions of the Act permanent will be considered in the near future.

Estimation Method: Because the Indiana Estate Tax does not have to be paid until 12 months after the decedent's death, the impact of changes to the unified credit and phaseout of the state death tax credit likely will be delayed until FY 2003. Based on this timetable, the flow of revenue from the Indiana Estate Tax likely will cease in FY 2007.

The revenue impact for each year is the difference between estimated Estate Tax revenue under the old and new regimes. The impacts are derived through simulations utilizing an OFMA database of Estate Tax returns relating to decedents who died between July 1, 1997, and June 30, 2000. The database consists of 559 estates upon which Indiana Estate Tax was paid. In performing the simulations, returns are excluded when necessary to account for the different unified credit levels, and necessary adjustments are made to the database to account for changes in the state death tax credit. The revenue impacts are based on an estimate of Estate Tax revenue for FY 2003 derived from the Revenue Technical Committee's updated FY 2003 Inheritance Tax forecast (as of November 14, 2001). The forecast total is $140 M, which includes revenue from the Indiana Estate Tax. Based on FY 2001 collections, about 17.7% of this total is derived from the Estate Tax. This suggests that Estate Tax revenue will total approximately $24.8 M in FY 2003. Percentage reductions in the Estate Tax liability in the database due to pertinent changes in the unified credit and state death tax credit are utilized to reduce the FY 2003 estimate accordingly. Estimated Estate Tax revenue under the old and new regime, and the net revenue loss, are presented in the table below.

Fiscal Year	Estimated Revenue Under Prior Federal Law	Estimated Revenue Under Current Federal Law	Net Revenue Loss
2003	$24.8 M	$17.4 M	($7.4 M)
2004	$24.6 M	$7.0 M	($17.6 M)
2005	$23.7 M	$2.7 M	($21.0 M)
2006	$22.2 M	$735,000	($21.5 M)
2007	$21.4 M	$0	($21.4 M)
2008	$21.2 M	$0	($21.2 M)

A summary of the revenue impact of the *Economic Growth and Tax Relief Reconciliation Act of 2001* (HR 1836) is outlined in the table below. This assumes that Indiana updates the Internal Revenue Code reference in IC 6-3-1-11 to January 1, 2002, to incorporate all the Internal Revenue Code changes made to date including those referenced above in HR 1836.

Provision (revenue impact in $M)	FY 2002	FY 2003	FY 2004	FY 2005
Education IRAs	(.50)	(1.07)	(1.44)	(1.77)
Qualified Tuition Plans	(.06)	(.15)	(.24)	(.34)
Employer-Provided Assistance	(1.28)	(2.21)	(2.48)	(2.62)
Qualified Higher Ed Expenses	(3.80)	(6.37)	(8.34)	(9.42)
Student Loan Deduction	(.42)	(.75)	(.85)	(.90)
Tax-Exempt Bond Financing	(.01)	(.05)	(.11)	(.18)
Pension & IRA Provisions	(2.14)	(5.37)	(7.51)	(9.97)
Net Impact of AGI Provisions	(8.21)	(15.97)	(20.97)	(25.2)
Estate Tax Revenue Provisions		(7.40)	(17.60)	(21.0)
Total Impact on State Revenue	(8.21)	(23.37)	(37.57)	(46.2)

Explanation of Local Expenditures: (Revised) **(C)** ***South Bend Community Schools Budget Cycle:*** South Bend Community School Corporation may have some small expenses associated with changing from a school year to a calendar year budget.

Explanation of Local Revenues: (Revised) **(F)** ***South Bend Economic Development Project District*: If** the South Bend Redevelopment Commission utilizes the incremental Sales Tax provisions in this bill, it could increase local revenue by up to $1 M annually. The bill specifies that this revenue could only be used for: improvements related to roads, interchanges, and right-of-ways; certain acquisition and demolition costs; and for physical improvements to a property to enhance the commercial viability of the specified economic development project district.

State Agencies Affected: All; Department of State Revenue; Department of Local Government Finance (State Tax Board).

Local Agencies Affected: Counties; Assessors; Auditors, South Bend Community Schools; South Bend Economic Redevelopment Commission.

Information Sources: Jim Mundt, Department of State Revenue, 232-8022; Bill Reynolds, Indiana Department of Revenue, 232-2156; Joint Committee on Taxation, *"Summary of Provisions Contained in the Conference Agreement for H.R. 1836, The Economic Growth and Tax Relief Reconciliation Act of 2001."* May 26, 2001; OFMA Estate Tax database; Revenue Technical Committee Forecast, November 11, 2001; Joint Committee on Taxation; the Commerce Clearing House; the Research Institute of America, Inc.; and the Federal Tax Administrators.